State Policy on Banking Capital Regulation Based on Supply Chain Management

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Abstract*—The introduction of supply chain managements (SCM) and standardized financial instruments to improve the financial market regulation of Kazakhstan requires the reallocation of resources in favor of Islamic banking capital due to the rapid growth of their share in international finances. Supply chain effects mean that highly levered financial intermediaries are the most efficient. Low asset volatility enables banks to safely take on high leverage; supply chain effects compel them to do so. The purpose of the research is to study the key aspects of increasing the effectiveness of state policy on banking capital regulation taking into account the supply chain management in Kazakhstan. To conduct the study, the Islamic Finance Development Indicator (IFDI) was used. This is a composite index reflecting the development of the Islamic finance industry by assessing the effectiveness of all its components in accordance with its supply chain process. In the context of this indicator, the study focuses on the development of Islamic banking assets in Kazakhstan for the period from 2015 to 2019. It has been found that Islamic banks have a diversified business model and a high level of asset efficiency; they are more stable compared to traditional banks. Malaysia and the United Arab Emirates are the leaders in the SCM in finance industry. A model of state regulation of Islamic banking capital in Kazakhstan related to the development of Islamic banking, the capital market, Islamic non-banking and micro-finance institutions, as well as the elimination of obstacles (ijara, mudaraba, murabaha and wakala) has been proposed. The developed model creates a number of advantages for the state: the possibility of creating a sovereign sukuk, issuing Islamic corporate securities, developing and attracting portfolio investments and alternative financing, as well as increasing the image of Kazakhstan in the development of Islamic banking capital. is a meaningful tool for the banking firms or the organizational performance and various departmental heads are very much aware to SCM practices for the greater banking performance.

***Keywords*—** *Islamic finance, Islamic banking, capital, investment, supply chain management, financial performance*

1. Introduction

In existing studies, various factors have been discussed which are playing their role. These factors are entitled as the supply chain integration or supply chai integration as explained by [1], collaboration within and outside the organization [2-4] sharing of information between the parties and key stakeholders and finally the visibility of the information as well [5-8]. Banking institutions and their capital are an important means and source of the country's economic growth. The role of banks in performing these functions is determined by financial stability based on the availability of bank capital [1]. Islamic banks, like traditional banks, are financial intermediaries, but they must adhere to the basic principles of Islamic law (Sharia). The prohibition of interest charges is the main difference between Islamic and traditional banks. This arises from the idea that interest charge is a form of exploitation and inherently contradicts Islamic values of justice; Islamic banks are also forbidden to speculate in the form of risky or uncertain commercial enterprises, as well as to finance haram activities [2].

Over the last twenty years, the Islamic finance industry has significantly grown. Today, it accounts for 1.814 trillion US dollars (six-fold increase over the past decade). Most transnational financial institutions, such as global banking, investment, consulting, accounting or information companies participate in Islamic finance. Nowadays, Islamic financial institutions operate in at least 105 countries. Most of these countries have already introduced (or are considering introducing) legislation to provide a regulatory framework for the development of this type of financial industry [3].

In the Islamic world, financial institutions are major economic actors. Five countries dominate Islamic banking: Iran ($ 345 billion dollars), Saudi Arabia ($ 258 billion), Malaysia ($ 142 billion), Kuwait ($ 128 billion), and the United Arab Emirates ($ 112 billion). Several non-Muslim countries, including Britain and Singapore, have announced their intention to become centers of Islamic finance, while other states (for example, Australia, France and South Korea) have changed their legislation to become more receptive to Islamic finance [4]. A number of interrelated factors create a boom in Islamic finance and show no signs of weakening. At first, minor Islamic financial products have multiplied in recent years and gradually attracted an increasing number of customers. Non-Islamic financial institutions that used to ignore the Islamic market have paid close attention to it. Islamic financial institutions have received an additional impetus due to rising energy prices and the subsequently increased economic importance of oil-producing countries.

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Therefore, objective demographic, political and economic factors determine the growing role and influence of the Islamic finance industry on regional financial markets, as well as international finance. This explains the relevance of further research in this field.

2. Literature review

Over the last years, Muslims have become increasingly active participants in the economy of the European Union creating businesses and hiring skilled workers. At the same time, Islamic banking has intensified. In the Great Recession, Islamic banks remained stable and became their own sources of investment [5; 6]. Islamic industry of financial products and services recognizes the importance of understanding consumer behavior. In addition, understanding of consumer behavior changes and proper business adjustment in accordance with them are required in order to ensure market competitiveness of any financial institution [7; 8].

The intersection of financial stability and religion reveals the principles and values of large financial institutions [9]. Following the Saudi Arabia business model that is closely linked to deep-rooted Islamic banking principles, a Sharia banking group can play an important role in bridging the gap between modern financial requirements and the inherent Islamic values for numerous industry standards and state development [10; 11].

There is no significant difference between Islamic and traditional banks in terms of economic efficiency [12]. However, Islamic banks demonstrated a higher level of stability during crisis periods. Therefore, today it can be argued that the Islamic banking model is significantly different from the traditional model. Islamic banks are less cost-effective [13], but more reliable [14]. Moreover, Islamic banks are better capitalized and more stable compared to traditional banks [15].

There is a significant gap in modern literature. Previous studies examined the impact of macroeconomic indicators on Islamic and traditional banks [16], but they did not focus on the behavior of Islamic banks in relation to various business cycle phases. The literature review also shows conflicting results regarding the differences between Islamic and traditional banks.

In most countries where Islam is professed by the vast majority of the population, there is still no special legislation for Islamic financial institutions, in particular Islamic banks [17]. For example, Islamic banks in Turkey are called participation banks. Kazakhstan is also a country with a Muslim majority, in which the civil law system is similar to the Russian one. In addition, Kazakhstan is the first country in the Commonwealth of Independent States (CIS) to amend its legislation and include Islamic finance. Uzbekistan is another CIS country characterized by the vast majority of Muslim population. However, Islamic finance legislation has not been introduced yet [7]. Therefore, a study on the impact of state policy on banking capital regulation taking into account the supply chain management will close the gap in the literature, as well as provide new conclusions and research results for politicians and regulatory bodies.

2.2 Setting objectives

The role of SCF is to optimize both the availability and cost of capital within a given buyer-supplier supply chain. Technology can aid in aggregating, packaging, and utilizing various information generated during supply chain activities to manage risk. To add further value, information on the physical flow of goods can be monitored. The coupling of information enables lenders to mitigate financial risk within the supply chain. The mitigation of risk allows more capital to be raised, capital to be accessed sooner, or capital to be raised at lower rates. In Kazakhstan, the 71st step of the Plan of the Nation "100 concrete steps to implement five institutional reforms" provides for the development of a financial center strategy focused on serving capital markets and Islamic finance, as well as the development of new types of elite financial services, including private banking and asset management [18]. It is necessary to create an effective financial system connected with the real production process and backed by real assets. In this case, Islamic financial instruments play an important role. They are directly related to the production process and allow localization of existing risks. Therefore, Islamic finance should be considered in addition to traditional financial institutions. In Kazakhstan, these are additional financing sources.

The biggest advantage of Islamic finance is the absence of speculation. The introduction of liquid and standardized financial instruments to improve the financial market regulation of Kazakhstan requires the reallocation of resources in favor of Islamic banking capital due to the rapid growth of their share in international finances. Thus, the purpose of the research is to study the key aspects of increasing the effectiveness of state policy on banking capital regulation taking into account the supply chain management in Kazakhstan. The following research tasks were set and solved:

– features of the Islamic finance development in different countries and regions have been described;

– key trends and factors for increasing Islamic banking assets in the leading countries and Kazakhstan have been identified;

– a model of state regulation of Islamic banking capital in Kazakhstan has been constructed;

prerequisites and opportunities for increasing the efficiency development and attraction of banking capital in Kazakhstan have been identified.

3. Methods and materials

The study is based on the methodology of the Islamic Corporation for the Development of the Private Sector (ICD), the Islamic Development Bank (IsDB) and Refinitiv, namely, the Islamic Finance Development Indicator. It is a reliable indicator of the state of the whole industry. The indicator is used in order to introduce a new method of measuring development by combining data from various industry elements into one common integrated indicator. The information on the indicators obtained for different countries facilitated further understanding of the development of various market segments.

The Islamic Finance Development Indicator (IFDI) is a composite index reflecting the development of the Islamic finance industry by assessing the effectiveness of all its components in accordance with its supply chain process. This is a global composite indicator that consists of country- and unit-specific level indicators [19].

The indicator is published annually along with a detailed report describing the indicator for a specific country and unit. Each sub-indicator of the integrated indicator is equally weighted and aggregated. In addition, the data are normalized before aggregation as the data set variables have different measurement units.

The country-level indicators are normalized to provide meaningful comparisons over time for a given country and between countries. Various economic indicators are considered (for example, population) and the state of Islamic finance is measured in each country.

In the context of this indicator, the study focuses on the development of Islamic banking assets for the period from 2015 to 2019.

To efficiency of banking capital development was studied in the following countries: Malaysia, Bahrain, the United Arab Emirates, Saudi Arabia, Jordan, Pakistan, Kuwait, Oman, Brunei Darussalam. These states are world leaders in the development of Islamic banking capital; Cyprus and Indonesia have demonstrated the highest rates of development of Islamic banking capital in recent years; Great Britain announced its strategic intention to become the European center of Islamic banking; Germany, France and Italy are the most open European countries to Islamic finance; a model of state regulation of banking capital taking into account supply chain management has been formed based on the example of Kazakhstan. Both traditional and Islamic banks are actively developing in all the countries studied.

4. Results

According to the Resilient Growth report on Islamic finance development, Islamic financial assets are expected to reach $ 3.5 trillion by 2021 [20]. Recognizing the great growth potential of Islamic banking, the Kazakh financial sector has shown increased interest in the Islamic banking industry.

European countries, mainly Great Britain, Germany, Italy, France and Luxembourg, have adopted Islamic finance. Spain is the only state in Europe where there is no Islamic banking. However, more and more institutions offering education in Islamic finance are appearing across the country. Islamic finance in Europe has gained close attention since the first issue of Islamic bonds (Sukuk) in the UK and Luxembourg.

Malaysia and the United Arab Emirates are still the industry leaders while Cyprus and Indonesia are among the most active players in the ranking as a result of improving their financial and supporting ecosystem indicators (Table 1).

Table 1. Islamic banking assets ($, million)

No.	Country	2015	2016	2017	2018	2019
1	Malaysia	17395.6	15998.6	165480.2	201392.3	214489.7
2	United Arabic Emirates	127280.9	148186.6	163121.3	180258.9	194126.9
3	Cyprus	-	17.7	27.7	175.4	260.7
4	Indonesia	21711.5	20081.1	26219.8	29224.5	28340.3
5	Kazakhstan	73.9	39.7	63.2	70.1	91.3
6	Turkey	44597.3	41692.9	37692.2	41379.1	39228.7
7	Great Britain	3970163.2	3984167.2	4371365.4	5231501.5	5867808.8

Source: own development (based on [19])

Currently, two Islamic banks operate in 33 second-tier banks in Kazakhstan: JSC Al Hilal Islamic Bank and JSC Zaman-Bank. Al Hilal Islamic Bank has been in business since 2010 and it works mainly with large corporate clients. Zaman-Bank became an Islamic bank in 2017. It focuses on products for retail and small and medium-sized businesses.

The results of assessing the current state and growth potential of Islamic finance are presented in Fig. 1.

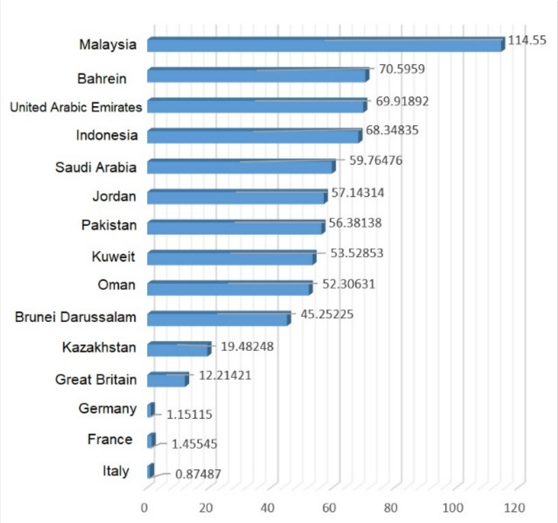

Figure 1. The Islamic Finance Development Indicator (IFDI), 2019 (developed by authors on the basis of source [19])

To compare the effectiveness of the state policy on regulating Islamic banking capital in Kazakhstan, 10 global leading countries and 4 European leading countries were selected based on the Islamic Finance Development Indicator (IFDI). In terms of this indicator, Kazakhstan surpasses European countries, including Great Britain, which is the European center of Islamic banking.

Considering the need to increase the effectiveness of state policy on regulating banking capital in Kazakhstan, a model of its development taking into account the supply chain management is presented (Fig. 2).

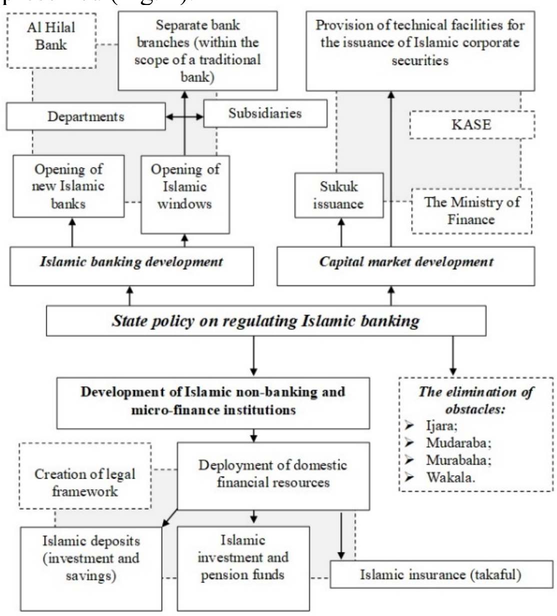

Figure 2. A model of state regulation of Islamic banking capital in Kazakhstan (developed by authors)

The model is based on the study of banking capital development experience of Malaysia, Indonesia, Cyprus and the United Kingdom. These states are the leaders in the industry. The proposed model takes into account the restrictions imposed by Al Hilal Bank on its operations when providing services to large corporate clients, as well as the complete lack of financing for small and medium-sized businesses and individuals, which makes it possible to create favorable conditions for attracting financial resources. This can be done by opening new Islamic banks or the so-called “Islamic windows” in conventional commercial banks. This will also require technical costs and bring administrative and bureaucratic problems. However, there will be an advantage - no amendments to the legislation will be needed.

Currently, Kazakhstan needs to create mechanisms to open “Islamic windows” as separate bank branches within the scope of a traditional bank (following the example of Saudi Arabia and Qatar); the UAE, Bahrain and Malaysia, based on existing infrastructure, are creating departments that allow traditional banks to offer an Islamic product; in Turkey and Kuwait, where one legal entity can't have both traditional and Islamic banking licenses, traditional banks create special subsidiaries to obtain an additional license.

According to the recommended model, it is necessary to develop Islamic non-banking micro-finance institutions and create an appropriate legislative framework. The deployment of domestic financial resources, including those that are not covered by traditional financial instruments, can be carried out through Islamic deposits (investment and savings deposits), Islamic insurance (takaful), Islamic investment funds and pension funds.

5. Discussion

Supply Chain Finance should be more broadly interpreted to encompass any financing solution that supports the buyer/seller supply chain, whether it is domestic or global. Therefore, market participants should take an expanded view on supply chain finance (including areas such as pre-shipment finance, purchase order financing, inventory finance, distribution finance, etc.). Kazakhstan has a fundamental regulatory framework for its own national sphere of Islamic finance and for cross-border operations. However, it should be noted that the country faces problems associated with the perception and use of this phenomenon by the population, as well as small and medium-sized businesses. Therefore, the government of Kazakhstan should focus on attracting Islamic finance with the help of the Astana International Financial Center following the example of Malaysia and the Persian Gulf countries [21]. This will allow the implementation of large infrastructure and public-private partnership projects with due regard to the legal framework improvements [14].

Thus, it is appropriate to identify two main directions of possible cooperation between the national banking system and Islamic banks: opening of "Islamic windows" and attracting this capital to finance investment projects [22].

The main advantage of implementing the proposed model in Kazakhstan is determined by the presence of Muslim population. For example, Islamic finance cannot receive state support in Australia, where there are 281 thousand Muslims (1.5% of the total population) compared to other countries with a Muslim minority, where the share of the Muslim population is more than 20% of the state's population [7].

At the same time, some difficulties associated with the opening of "Islamic windows" in traditional commercial banks should be taken into account, namely: the need to amend the legal framework; the creation of risk-oriented supervision in Kazakhstan, which will help to timely prevent risks in a particular area; reputation risk tracking [17]. There is also a downward trend in the development of "Islamic windows" in the Middle East and the formation of new Islamic banks in Qatar and Bahrain. In addition, according to the proposed model of state policy on regulating Islamic banking capital, the creation of "Islamic windows" has several advantages: quicker return on investment; minimized costs of opening a new bank (there is no need to allocate capital for it) [23], the ability to diversify financial sources for the banks themselves [11], increased opportunities for retail lending and the use of the existing infrastructure of a traditional bank [24].

The issue related to overcoming the obstacles that are indicated in the proposed model and impede the Islamic banking capital development is particularly debatable. The following steps should be considered:

firstly, "non-consumable" objects can be the subject of Ijara (leasing) both in conformity with the civil legislation and the Law of the Republic of Kazakhstan "On Financial Leasing" (Article 566 of the Civil Code of the Republic of Kazakhstan). Therefore, the correction of this legislation will make it possible to use the product;

secondly, regarding the possibility of financing mudaraba, it is necessary to develop the ways allowing the Islamic bank to participate in the business financed by its clients;

thirdly, murabaha should be recognized as a commodity banking operation of an Islamic bank; it is necessary to introduce amendments to the tax policy and create an accelerated mechanism for registering property rights in murabaha banking transactions [25];

fourthly, it is necessary to develop and introduce the necessary changes in the regulatory framework of banking legislation in order to clarify the concepts and account for wakala operations [5].

The development of the Kazakh capital market can be negatively affected by the imperfect system applied to Islamic quasi-government and corporate securities, insufficient possibility of their issuance by foreign issuers, complication of the issuance by the Ministry of Finance, as well as the restrictions imposed by the AAOFI (2 out of 14 sukuk types can be issued).

According to the proposed model of the state policy on regulating Islamic banking capital to develop the capital market of Kazakhstan, the following advantages can be distinguished:

firstly, the presence of basic legislation, including regulatory legal acts at KASE;

secondly, a sovereign sukuk's possibility of creating a benchmark and prerequisites for further issuance of corporate Islamic securities;

thirdly, attraction and development of portfolio investments;

fourthly, attracting alternative investment in the real economy sector, as well as increasing the image of Kazakhstan to contribute to the development of Islamic banking capital.

6. Conclusions

The present study aims to examine the idea of supply chain management in the financial institutions like banks in the region of Kazakhstan. Islamic banks are characterized by a diversified business model; they have a high level of asset efficiency and are more stable than traditional banks. Given the significant growth potential of Islamic banking, Kazakhstan has shown an increased interest in the Islamic banking industry. EU countries are actively attracting Islamic finance after the first issue of Islamic securities (sukuk) by the UK and Luxembourg. Malaysia and the UAE are the industry leaders; Cyprus and Indonesia have demonstrated the highest rates of development of Islamic banking. According to the 2019 Islamic Finance Development Indicator (IFDI), Kazakhstan surpassed European countries, including the UK, which proclaimed itself the European Islamic banking center.

Based on the research on the development experience of Malaysia, Indonesia, Cyprus and the United Kingdom, a model of the state policy on regulating Islamic banking capital in Kazakhstan has been developed. The model provides for the implementation of the state policy in four areas: the development of Islamic banking, the capital market, Islamic non-banking and micro-finance institutions, as well as the elimination of obstacles (ijara, mudaraba, murabaha and wakala). This requires the creation of favorable conditions for attracting Islamic finance by opening new Islamic banks and windows in traditional banks. The deployment of domestic financial resources, including those that are not covered by traditional financial instruments, can be carried out through Islamic deposits (investment and savings deposits), Islamic insurance (takaful), Islamic investment funds and pension funds. For each direction of the state policy on regulating Islamic banking capital, possible problems and advantages as a result of their implementation have been identified.

The proposed model has important policy implications for regulatory agencies. It helps them formulate strategies based on the differences in the business models of Islamic and traditional banks. It is noteworthy that both types of banks should be treated differently in terms of the development and implementation of banking regulation due to the differences in their fundamental principles. According to the developed model, the state has a number of advantages in the light of the availability of a sufficient legislative platform and KASE regulatory acts, namely: the possibility of creating a sovereign sukuk, issuing Islamic corporate securities, developing and attracting portfolio investments and alternative financing, as well as increasing the image of Kazakhstan in the development of Islamic banking capital.

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